



## North Carolina Retirement Systems

### *Anti-Pension Spiking Contribution-Based Benefit Cap*

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North Carolina Department of State Treasurer  
*Learn. Invest. Grow. Prosper.*

# What is Pension Spiking

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- Pension spiking is a substantial increase in compensation that results in unusually high liabilities to the Retirement System.
- These unforeseen liabilities are then absorbed by other members and employers in the Retirement System.
- Pension spiking is not a pervasive problem in North Carolina, but the Retirement Systems' actuary found enough instances that a solution is warranted.



# Before Legislation: Cost Shift by Pension Spike

	EMPLOYER ONE	EMPLOYER TWO	EMPLOYER THREE
		[SPIKER]	
Annual Retirement Benefit:	\$90,000	\$90,000	\$90,000
Present Value of Future Retirement Benefits	\$1,000,000	\$1,000,000	\$1,000,000
Contributions	\$400,000	\$225,000	\$400,000
Plus Investment Gains	<u>+ \$600,000</u>	<u>+ \$175,000</u>	<u>+ \$600,000</u>
	\$1,000,000	\$400,000	\$1,000,000
Liability:	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Employer's Impact on Next Year's Liability:	\$0	\$600,000	\$0
Liability Payment Due:	\$200,000	\$200,000	\$200,000

Prior to the passage of the new Anti-Pension Spiking law, the unforeseen liabilities were shared by all the employers of the Retirement System

Unforeseen Liability for Pension Spike



# After Legislation: Cost Shift by Pension Spike

	EMPLOYER ONE	EMPLOYER TWO	EMPLOYER THREE
		[SPIKER]	
Annual Retirement Benefit:	\$90,000	\$90,000	\$90,000
Present Value of Future Retirement Benefits	\$1,000,000	\$1,000,000	\$1,000,000
Contributions	\$400,000	\$225,000	\$400,000
Plus Investment Gains	<u>+ \$600,000</u>	<u>+ \$175,000</u>	<u>+ \$600,000</u>
	\$1,000,000	\$400,000	\$1,000,000
Liability:	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Employer's Impact on Next Year's Liability:	\$0	\$600,000	\$0
Liability Payment Due:	\$0	\$600,000	\$0

On and after January 1, 2015, under the new Anti-Pension Spiking law, the cost of the unforeseen liability is paid by the employer or employee who caused the pension spike.

Unforeseen  
Liability for  
Pension Spike







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# THE SPIKE ZONE:

## New Pension Spiking Law Explained



# How does the new game work?

Example		Meaning
	Baseball	Retirement Application Form (Form 6)
	Pitcher	Members
	Batter	The Retirement System
	Umpire	The Anti-Pension Spiking Law

- Before the Anti-Pension Spiking law, the Retirement System had to swing at every pitch.
- The Anti-Pension Spiking law introduces an umpire to ensure more quality pitches.



# Which pitches are reviewed?



- The umpire monitors the playing field to determine which pitches are considered fair.
- The umpire only makes a call on pitches with an Average Final Compensation (AFC) of \$100,000 or more, adjusted annually for inflation.
- For pitches with an AFC under \$100,000, the Retirement System always hits a home run!





# Pitch the umpire does not review



If the pitcher throws a ball with an AFC under \$100,000 the batter swings and hits the ball out of the park. It's a home run!

But how did the batter know to swing?

Since the pitcher's AFC was under \$100,000, the umpire does not review the pitch.

The member's retirement benefit is processed and paid.



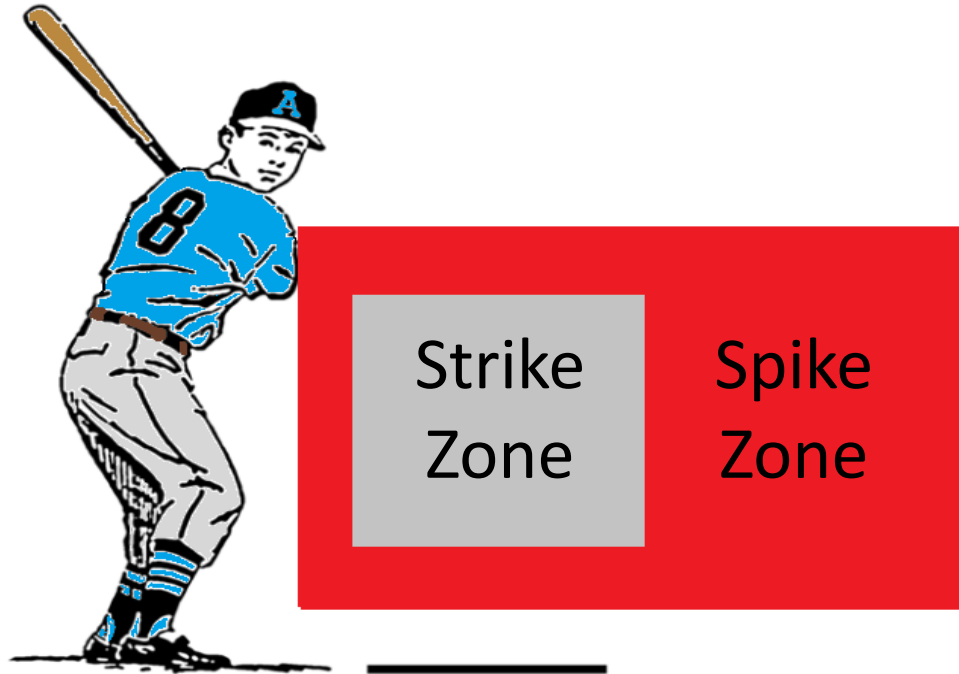


# Which balls enter the SPIKE ZONE?

- For pitches with an AFC over \$100,000, the umpire determines which are in the STRIKE ZONE...

...and which are in the **SPIKE ZONE**.

- The next few slides will show how the umpire makes the call.



# Pitch in the STRIKE ZONE

Example of a pitch over the plate:



Name	Prudence Parker
System	Local Governmental
Retirement System Entry Date	1/1/1985
Retirement Date	1/1/2015
Age at Retirement	58
Years of Service	30
AFC	\$200,000
Pension Benefit	\$111,000 per year

- Prudence Parker received regular raises of 6% per year and did not receive a pension spike during the AFC period.
- The umpire reviews the pitch and determines that it is in the STRIKE ZONE.

**Amount Employer Owes Retirement System = \$0**

This example uses a hypothetical Pension Spiking factor of 5. The Board of Trustees will select a factor based on the advice of the actuary in October 2014.



# Ball in the SPIKE ZONE

Example of a ball that enters the SPIKE ZONE:



Name	Steven Spiker
System	Local Governmental
Retirement System Entry Date	1/1/1985
Retirement Date	1/1/2015
Age at Retirement	58
Years of Service	30
AFC	\$200,000
Pension Benefit	\$111,000 per year

- Steven Spiker received regular raises of 6% per year and receives \$50,000 in additional compensation as a result of benefit conversion during the AFC period.
- The umpire reviews the pitch and determines that it is in the SPIKE ZONE.

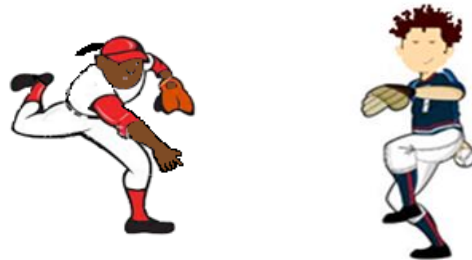
**Amount Employer Owes Retirement System  $\approx$  \$28,000**

This example uses a hypothetical Pension Spiking factor of 5. The Board of Trustees will select a factor based on the advice of the actuary in October 2014.



# Prudence Parker vs. Steven Spiker

- Both Prudence Parker and Steven Spiker retired on the same day from the same system with the same pension benefit.
- The big difference is that Prudence Parker and her employer paid more into the Retirement System than Steven Spiker and his employer.
- When Steven Spiker retires, his employer owes an additional ~\$28,000 to make up for this difference.
- This charge to the employer is the increased cost that the Retirement System would have borne in the absence of the new anti-spiking statute to pay the same benefit to Steven Spiker as Prudence Parker.



# The future of the SPIKE ZONE

- Example of a ball that enters the SPIKE ZONE after 2020:



Name	Steven Spiker, Jr.
System	Local Governmental
<b><i>Retirement System Entry Date</i></b>	<b><i>1/1/2015</i></b>
Retirement Date	1/1/2045
Age at Retirement	58
Years of Service	30
AFC	\$200,000
Pension Benefit	\$111,000 per year

- Just like his dad, Steven Spiker, Jr. received regular raises of 6% per year and an additional \$50,000 as a result of benefit conversion during the AFC period.
- The umpire reviews the pitch and determines that it is in the SPIKE ZONE.
- Since Steven Spiker Jr. first entered the Retirement System in 2015, he has options....



# Options for members first hired in 2015 or later

- When Steven Spiker, Jr. retires he has three options:
  1. His employer can choose to pay the ~\$28,000 owed to the Retirement System, or
  2. He can pay the ~\$28,000 himself, or
  3. He can choose to receive a reduced pension benefit.
- If Steven Spiker, Jr. chooses option #3, his annual pension benefit would be reduced by \$2,480 – from \$111,000 to \$108,520



# Calculation details for Prudence Parker



Average Final Salary		\$200,000
Years of Service	×	30
Local Governmental Multiplier	×	0.0185
<b>Maximum Benefit Amount<sup>+</sup></b>		<b>\$111,000.00</b>
Accumulated Contributions		\$313,551.17
Annuity Factor (for age 58)	÷	11.4455
Contribution Based Benefit Cap Factor*	×	5.00
<b>Contribution Based Benefit Cap</b>		<b>\$136,975.74</b>
<b>Amount Owed to Retirement System</b>		<b>\$0</b>

**The cap does not have an impact because the maximum benefit of \$111,000.00 is less than the cap of \$136,975.74.**

\*This example uses a hypothetical Pension Spiking factor of 5. The Board of Trustees will select a factor based on the advice of the actuary in October 2014.

\*Choice of an alternative retirement benefit payment option, such as a joint and survivor payment option, does not alter the calculation.





# Calculation details for Steven Spiker



Average Final Salary		\$200,000
Years of Service	×	30
Local Governmental Multiplier	×	0.0185
<b>Maximum Benefit Amount<sup>+</sup></b>		<b>\$111,000.00</b>
Accumulated Contributions		\$248,412.35
Annuity Factor (for age 58)	÷	11.4455
Contribution Based Benefit Cap Factor*	×	5.00
<b>Contribution Based Benefit Cap</b>		<b>\$108,519.66</b>
Maximum Benefit – Benefit Cap		\$2,480.34
Annuity Factor (for age 58)	×	11.4455
<b>Amount Owed to Retirement System</b>		<b>\$28,388.73</b>

**The cap has an impact because the maximum benefit of \$111,000.00 is greater than the cap of \$108,519.66.**

\*This example uses a hypothetical Pension Spiking factor of 5. The Board of Trustees will select a factor based on the advice of the actuary in October 2014.

\*Choice of an alternative retirement benefit payment option, such as a joint and survivor payment option, does not alter the calculation.



# Summary

- The Anti-Pension Spiking Contribution-Based Benefit Cap approach to limiting pension spiking will prevent employers in the Retirement Systems from absorbing the additional liabilities caused by pension spiking by other employers.
- The pension spiking cap only applies to individuals with an Average Final Compensation (AFC) of \$100,000 or higher, adjusted annually for inflation, and will only directly impact a small number of those individuals.
- The maximum number of people per year who can be affected by the cap is 0.75% of retirees.
- For members who enter the Retirement System from which they retire before January 1, 2015, the last employer will pay the cost of the additional liability on the Retirement System caused by the pension spike.
- For members who enter the Retirement System from which they retire on or after January 1, 2015, the employer or employee may pay for the additional liability, or the employee can choose to receive a reduced benefit.





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